

No. 14095.

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

SEABOARD FINANCE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

DANA LATHAM,

AUSTIN H. PECK, JR.,

HENRY C. DIEHL,

900 Wilshire Boulevard,

Los Angeles 17, California,

Attorneys for Petitioner.

FILED

JAN 6 3 1954

TOPICAL INDEX

	PAGE
Jurisdiction	1
Question presented	2
Statement of the case.....	2
Specification of errors.....	6
Summary of argument.....	7
Argument.....	8
I.	
Analysis of transaction pursuant to which Seaboard acquired the Campbell stock.....	8
II.	
General principles of law applicable to transactions involving foreign exchange	11
III.	
The Tax Court's ultimate findings and conclusions were clearly erroneous	12
A. The transaction in foreign exchange was separate from the Campbell purchase.....	14
B. Seaboard could not determine the cost of the Campbell stock in March, 1946.....	19
IV.	
Conclusion	23

TABLE OF AUTHORITIES CITED

CASES	PAGE
Bernuth Lembcke Co., 1 BTA 1051, acq. IV-2 Cum. Bull. 3.....	12, 22
Credit & Investment Corp., 47 BTA 673.....	12
Equitable Life Assurance Society v. Irelan, 123 F. (2d) 462.....	12
Joyce-Koebel Co., 6 BTA 403, acq. VI-2 Cum. Bull. 4.....	12, 22
P. Canizzaro & Co., 19 BTA 380.....	11
Smyth v. Barneson, 181 F. (2d) 143.....	12
Theodore Tiedemann & Sons, Inc., 1 BTA 1077.....	11
Tsivoglou v. United States, 31 F. (2d) 706.....	11
Willard Hilburn, Inc., 20 T. C., No. 106.....	24

STATUTES

Internal Revenue Code, Sec. 117(a)(1).....	11
Internal Revenue Code, Sec. 131.....	6
Internal Revenue Code, Sec. 272.....	1
Internal Revenue Code, Sec. 1141.....	2
Internal Revenue Code, Sec. 1142.....	2
United States Code Annotated, Title 26, Sec. 272.....	1

TEXTBOOKS

Cumulative Bulletin, 1920-2, p. 60, O. D. 419.....	11
Cumulative Bulletin, 1946-2, p. 55, I. T. 3810.....	11
3 Mertens, Law of Federal Income Taxation, p. 374.....	17

No. 14095.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SEABOARD FINANCE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

Jurisdiction.

This petition for review involves federal income taxes of Seaboard Finance Company, a corporation, for the fiscal year ended September 30, 1947.

The Commissioner of Internal Revenue determined a deficiency in the federal income taxes of Seaboard Finance Company (hereinafter called "Seaboard") and mailed a notice of deficiency [R. 11-16]. Seaboard thereafter filed a petition [R. 5-16] with The Tax Court of the United States (hereinafter called the "Tax Court") pursuant to the provisions of Section 272 of the Internal Revenue Code (26 U. S. C. A., Sec. 272). The decision of the Tax Court was in favor of the Commissioner of Internal Revenue (20 T. C., No. 54, 1953).

The petition for review was filed on or about August 21, 1953 [R. 72-74] pursuant to the provisions of Sec-

tions 1141 and 1142 of the Internal Revenue Code (26 U. S. C. A., Secs. 1141 and 1142).

Question Presented.

The question presented for adjudication in this proceeding is whether Seaboard realized a gain on foreign exchange in December, 1946, by virtue of the application of Canadian dollars, which had appreciated in value between the date of their purchase and the date of said application, on the purchase of property in Canada.

Statement of the Case.

Late in 1945, Seaboard, a Delaware corporation engaged in the small loan business in several states of the United States, learned that all of the issued and outstanding stock of Campbell Finance Corporation Limited (hereinafter called "Campbell") was available for purchase from its then owner, Industrial Acceptance Corporation Limited (hereinafter called "Industrial") [R. 52]. Both Industrial and Campbell were corporations organized and existing under the laws of Canada or a province thereof. Campbell was then engaged in the small loan business in Canada, operating approximately 50 offices. Campbell had 50,000 shares of common stock outstanding, these being the only issued and outstanding shares of stock of that corporation [R. 22].

In January or February, 1946 officers of Seaboard discussed with officers of Industrial the possibility of purchase by Seaboard of the Campbell stock. Industrial's asking price was approximately \$2,214,969.94 (Canadian), which figure exceeded the net book value of Campbell's assets by approximately \$1,000,000.00 [R. 52-53].

In the early months of 1946 Seaboard did not have sufficient cash resources, either in capital or ability to borrow, to meet Industrial's asking price in cash. In addition, the premium over net book value asked by Industrial was considered by Seaboard to be excessive [R. 54]. However, Seaboard desired to acquire the Campbell stock. Accordingly, Seaboard made an offer to Industrial to acquire the Campbell stock, the terms of which offer were embodied in an agreement dated March 27, 1946 [R. 53; 24-32]. By said agreement Industrial agreed forthwith to transfer and deliver the Campbell stock to Seaboard. Seaboard agreed contemporaneously to issue to Industrial 100,000 shares of Seaboard's then authorized but unissued common stock. Said shares were to be delivered to the Canadian Bank of Commerce [R. 24].

In addition, Seaboard agreed to proceed speedily with the preparation and submission to the United States Securities and Exchange Commission of a Registration Statement to cover said 100,000 shares so issued to Industrial, and to effect appropriate arrangements with investment bankers for the sale to said bankers, by Industrial, of the shares so issued by Seaboard to Industrial [R. 24-25]. Industrial was to be entitled to receive and retain from the sale to the investment bankers of said 100,000 shares of Seaboard stock \$2,214,969.94 (Canadian). If the proceeds of sale of said 100,000 shares to the bankers were not equivalent to that figure, Seaboard guaranteed to make good the deficiency either by issuing and delivering to Industrial additional shares of Seaboard's common stock or by making a cash payment equal to the deficiency [R. 25].

Under the agreement of March 27, 1946 Seaboard could, under described circumstances, rescind the trans-

action and return the Campbell stock to Industrial. In such event Seaboard would be subject to described penalties [R. 27-29]. However, unrestricted possession of the Campbell stock was given to Seaboard, and it had the power to dispose of said shares, although it agreed not to do so. Therefore, the agreement contained a provision that, for the protection and indemnification of Industrial against any loss or damage that might or could arise from Seaboard's default under the agreement, Seaboard would deposit with Industrial, as cash collateral security, the sum of \$2,200,000.00 (Canadian). Industrial agreed to pay interest to Seaboard at the rate of 4½% per annum on said funds so long as they should be on deposit as cash collateral [R. 29].

On March 27, 1946 Seaboard, through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares in the name of Industrial and delivered them to the Canadian Bank of Commerce, Montreal. From and after said date Industrial appeared on the stock transfer records and the share register of Seaboard as the owner of 100,000 shares [R. 34]. On the same date Industrial delivered to Seaboard the 50,000 shares of Campbell stock; and thereafter Seaboard appeared on the stock transfer record and share register of Campbell as the owner of all of the Campbell stock [R. 37].

Included in the written stipulation filed by the parties in the Tax Court was a provision that the fair market value of the 100,000 shares of Seaboard stock issued to Industrial pursuant to the March 27, 1946 agreement was, on the date of issue, \$12.50 per share, or an aggregate of \$1,250,000.00. Seaboard's management believed that when news of the acquisition of the Campbell stock by Seaboard became known the market value of Seaboard's

stock would rise [R. 54; 33]. Seaboard hoped that the proceeds of the sale by Industrial to the investment bankers of the 100,000 shares of Seaboard stock would equal or exceed \$2,214,969.94 (Canadian). In June, 1946 the over-the-counter quotations on Seaboard's common stock reached approximately \$22.00 per share, which condition continued through the middle of July, 1946 [R. 55-56; 33-34]. Thereafter the market for Seaboard stock, in line with the general market, declined so that by November 22, 1946 the market quotations were approximately \$17.00 per share [R. 34].

In May, 1946 Seaboard commenced the preparation of a Registration Statement. It was not filed until August 29, 1946, and became effective on November 22, 1946 [R. 38]. The preparation and filing of the Registration Statement were delayed because of problems encountered in the completion of an audit of Campbell and Seaboard [R. 39]. 100,000 shares of Seaboard stock were offered to the public through investment bankers on or about November 22, 1946. The net proceeds from the sale of the shares, after deduction for brokers' commissions, were \$1,440,000.00 (United States). The shares so sold through the investment bankers were the shares which had been issued by Seaboard to Industrial [R. 39-40].

In settling the accounts between the parties Industrial, in November, 1946, authorized the investment bankers to pay to Seaboard the net proceeds of the sale of Industrial's shares (\$1,440,000.00); and Seaboard authorized Industrial to apply the Canadian dollars which had been deposited as cash collateral security to the payment for the Campbell stock [R. 40-41].

In its United States income tax return for its fiscal year ended September 30, 1947 Seaboard reported a gain

on foreign exchange in the amount of \$189,000.00. When Seaboard purchased the \$2,200,000.00 (Canadian) for deposit as cash collateral security, a favorable rate of exchange existed which enabled Seaboard to acquire those Canadian dollars for only \$2,000,000.00 (United States). In November, 1946, when Seaboard authorized Industrial to take the Canadian dollars, the Canadian dollar was virtually at parity with the United States dollar. As a result, the \$2,200,000.00 (Canadian) were worth at that time \$2,189,000.00 (United States) [R. 42].

Seaboard treated the gain on foreign exchange above described as a transaction which occurred in Canada. In computing its credit for Canadian income taxes under Section 131 of the Internal Revenue Code Seaboard included said \$189,000.00 exchange gain as income from sources within Canada. By virtue of this action the proportion of Seaboard's income from sources within Canada to its income from all sources was increased; and such increase increased the amount of the permissible credit under Section 131 of the Internal Revenue Code.

Upon audit of Seaboard's income tax return the Commissioner of Internal Revenue (hereinafter called the "Commissioner") refused to recognize any gain on foreign exchange, and reduced Seaboard's Canadian income tax credit accordingly [R. 13-16]. The deficiency here in controversy results entirely from that action by the Commissioner.

Specification of Errors.

(1) The Tax Court erred in its ultimate finding, or conclusion, that Seaboard's use of foreign exchange in the purchase of Campbell stock did not constitute a transaction in foreign exchange requiring recognition of a tax-

able gain separate and apart from the subsequent sale of the Campbell stock.

(2) The Tax Court erred in its finding that the cost of the Campbell stock to Seaboard was \$2,214,969.94 (Canadian) converted into United States dollars at the rate of exchange prevailing on March 27, 1946.

(3) The Tax Court erred in its finding, or conclusion, that Seaboard could and should have determined its cost of the Campbell stock as of March 27, 1946.

(4) The Tax Court erred in its finding that the 100,000 shares of Seaboard stock issued to Industrial were merely issued as security.

(5) The Tax Court erred in its conclusion that any gain on purchase and sale of Canadian dollars was offset by an equivalent loss measured by the difference between the purchase price of the Campbell stock, converted into dollars at the time of purchase, and the amount of American dollars required to purchase the same number of Canadian dollars when payment was subsequently made.

Summary of Argument.

Seaboard acquired the 50,000 shares of Campbell stock on March 27, 1946. It paid therefor 100,000 shares of its own common stock as an original issue.

The \$2,200,000.00 (Canadian) transmitted to Industrial on March 30, 1946 was a cash collateral deposit made pursuant to the provisions of the agreement of March 27, 1946 for the purpose of securing performance by Seaboard of its obligations under said agreement. It was not payment for the Campbell stock.

Notwithstanding that Seaboard acquired the Campbell stock on March 27, 1946, the cost thereof to Seaboard

was not determined or determinable until November, 1946 when the 100,000 shares of Seaboard stock, which had been issued to Industrial on March 27, 1946, were marketed by Industrial.

The application of the Canadian dollars, which had been deposited in Canada as cash collateral, in satisfaction of the obligations imposed upon Seaboard by the March 27, 1946 agreement resulted in the realization of a gain on foreign exchange in the amount of \$189,000.00 (United States).

ARGUMENT.

I.

Analysis of Transaction Pursuant to Which Seaboard Acquired the Campbell Stock.

When Industrial offered the Campbell stock for sale to Seaboard, it wished, if it could, to receive its asking price in full, and to be guaranteed a full cash payment. Seaboard desired to acquire the Campbell stock, but was unable to raise funds sufficient to cover the asking price in cash. Moreover, Seaboard was unwilling to pay a bonus of \$1,000,000.00 over net book value if that bonus had to be paid as an out-of-pocket expenditure of cash. Accommodation of the conflicting desires of the parties was necessary.

Seaboard foresaw the possibility of an appreciation in the market value of its stock if it were to acquire Campbell. Public information as to the acquisition of Campbell would, it was believed, stimulate the market for Seaboard's common stock. The agreement of March 27, 1946 was executed by Seaboard in the light of that possibility. By the agreement Seaboard acquired immediate ownership of all of the Campbell stock, with all of the

financial benefits which such ownership would entail. Its only outlay at the time was the issuance of 100,000 shares of common stock to Industrial. Seaboard thus acquired ownership of Campbell without any cash outlay whatsoever.

There can be no question on the facts in this case that Industrial became, on March 27, 1946, the owner of the 100,000 shares of Seaboard stock. In its initial statement [R. 44] that said 100,000 shares were deposited in escrow as security, the Tax Court erroneously found to the contrary. That finding is without support in the record. Physical possession of the shares was, it is true, given to the Canadian Bank of Commerce, which acted as escrow holder. Said escrow was not for securing Industrial, however. It was provided in the contract of March 27, 1946 that the Seaboard shares were to be marketed for the account of Industrial. In the opinion of Seaboard's counsel, a sale of the shares in the United States (the only available market for the stock) by Industrial would necessitate registration with the Securities and Exchange Commission. Immediate filing of a Registration Statement was impossible. Therefore, Seaboard insisted, as a means of protecting itself from possible liability under the Securities Act of 1933, that the 100,000 shares be held in escrow pending the filing of a Registration Statement. The escrow, which merely restricted the transferability of the shares, did not affect Industrial's ownership.

Preparation of the Registration Statement was commenced early in May, 1946. It was hoped that the Statement could be filed and become effective by June or early July. Had it become effective during that period, when a strong over-the-counter market for Seaboard stock existed, the sale by Industrial of the 100,000 shares of Seaboard stock would have produced the entire cash re-

ceipt which Industrial sought. But because of unavoidable delays in the filing of the Registration Statement and the consummation of arrangements with underwriters, Industrial's shares of Seaboard stock could not be marketed until November. As it was, the net proceeds from the sale of the 100,000 shares was \$1,440,000.00 (United States). Under its guaranty Seaboard had to make a cash payment or issue additional shares of its common stock. It chose to make a cash payment.

In clearing the accounts between the parties Seaboard and Industrial, for purposes of convenience, authorized the application of the cash collateral deposit of \$2,200,000.00 (Canadian) in settlement for the 50,000 shares of Campbell stock, and Industrial authorized the investment bankers to pay to Seaboard the \$1,440,000.00 (United States) proceeds from the sale of 100,000 shares of Seaboard stock marketed on Industrial's behalf.

The cash collateral deposit had been made in March, 1946 pursuant to the requirements of the agreement. Seaboard used \$2,000,000.00 (United States) to purchase \$2,200,000.00 (Canadian). This advantageous purchase could be made because of the favorable rate of exchange then existing between the Canadian and the United States dollar. But when those Canadian dollars were applied in December, 1946 in settlement of the guaranty to Industrial, the Canadian dollar had risen to virtual parity with the United States dollar. The 2,200,000 Canadian dollars which had been purchased for 2,000,000 United States dollars had become, by virtue of the exchange fluctuation, convertible into 2,189,000 United States dollars (the \$11,000.00 difference represented a discount of $\frac{1}{2}$ of 1% chargeable upon conversion). It was this benefit which Seaboard treated as a Canadian gain on exchange.

The evidence supports no finding other than that the March 27, 1946 agreement, and all documents executed pursuant thereto, accomplished no purchase by Seaboard of Campbell stock for cash but rather an acquisition by Seaboard through issuance of shares of its own stock, with provision for a later adjustment dependent upon subsequent events. The deposit of cash collateral was not intended by the parties to be, and was not in fact, payment of the purchase price.

II.

General Principles of Law Applicable to Transactions Involving Foreign Exchange.

Income returnable for United States income tax purposes must be expressed in United States dollars. Where foreign exchange is involved, the rate of exchange at the time of realization of the gain governs in making the computation of the amount of gain. *O.D. 419*, 2 Cum. Bull. 60 (1920). Transactions in foreign exchange involve the purchase and sale of foreign currency or the purchase of such currency and the application of it upon the purchase price of property. Such transactions may occur either in the conduct of a trade or business, or as a speculation or investment. *I.T. 3810*, 1946-2 Cum. Bull. 55. The same ruling states that foreign currency is a capital asset under Section 117(a)(1) of the Internal Revenue Code.

No gain or loss is realized on the mere appreciation or shrinkage of value, in United States dollars, of foreign currency. *Theodore Tiedemann & Sons, Inc.*, 1 BTA 1077 (1925); *Tsivoglou v. United States* (CA-1, 1929), 31 F. (2d) 706; *P. Canizzaro & Co.*, 19 BTA 380 (1930). It is necessary that there be a conversion of the foreign

currency in order that gain or loss may be deemed to have been realized. The realization of the gain or loss is postponed until the foreign currency is disposed of or converted.

It is not necessary that the foreign currency be exchanged for United States currency. It is sufficient that the foreign currency be disposed of by applying it in payment for merchandise or the like. *Joyce-Koebel Co.*, 6 BTA 403 (1927), *acq.* VI-2 Cum. Bull. 4 (1927); *Credit & Investment Corp.*, 47 BTA 673, 680 (1942); *Bernuth Lembcke Co.*, 1 BTA 1051 (1925), *acq.* IV-2 Cum. Bull. 3 (1925).

III.

The Tax Court's Ultimate Findings and Conclusions Were Clearly Erroneous.

This case was presented to the Tax Court primarily upon a written stipulation of facts filed by the parties. The only oral testimony presented was that of W. A. Thompson, a witness on behalf of Seaboard. The Commissioner produced no witnesses.

The Tax Court's evidentiary findings of fact [R. 21-44] are based on the matters contained in the written stipulation and the testimony of the one witness. Except as challenged herein those evidentiary findings of fact substantially paraphrase the written stipulation. Accordingly, under the decisions of this Court, the Court is in just as good a position as the Tax Court to decide whether or not the ultimate findings of fact are correct. *Equitable Life Assurance Society v. Irelan* (CA-9, 1941), 123 F. (2d) 462; *Smyth v. Barneson* (CA-9, 1950), 181 F. (2d) 143.

In its analysis of this case, in making its ultimate findings of fact, and in its conclusions, the Tax Court was guilty of two fundamental errors. The challenged findings of fact, which, we submit, are clearly erroneous, are as follows:

(1) That Seaboard's use of foreign exchange in the purchase of Campbell stock in accordance with obligations incurred under the purchase contract of March 27, 1946 did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the stock [R. 44].

(2) That Seaboard could determine its cost of the Campbell stock on March 27, 1946 [R. 48].

The Tax Court also made at least one evidentiary finding which is clearly erroneous. This is the finding that the 100,000 shares of Seaboard's stock which were issued by Seaboard in connection with this transaction were required to be deposited in escrow *as security* pending completion of the details of sale [R. 45].

The Tax Court's ultimate findings of fact and its conclusions are based upon a misconception of the transaction and a disregard of the provisions of the contract between Seaboard and Industrial. The Tax Court erroneously found, in effect, that Seaboard agreed to pay a specified number of Canadian dollars for the Campbell stock and, as a means of obtaining said dollars, sold to the public, for Seaboard's own benefit, 100,000 shares of its common stock. This view of the case led to the determination that Seaboard's cost could be determined in dollars and cents at the date the contract was entered into. This approach is clearly erroneous.

A. The Transaction in Foreign Exchange Was Separate
From the Campbell Purchase.

The Tax Court's opinion commences [R. 44] with the statement that Seaboard committed itself to purchase the Campbell stock by guaranteeing to Industrial \$2,214,969.94 (Canadian), which amount was to be realized first out of the sale of 100,000 shares of Seaboard's stock issued to Industrial, but to be sold by Seaboard, and secondly, from Seaboard's agreement to make good any deficit. Stopping at this point, it will be noted that the Tax Court recognized that the 100,000 shares of Seaboard's stock were actually issued to Industrial. Though the opinion [R. 45] implies the contrary, the only proper finding based upon the record is that they were then sold by *Industrial* pursuant to arrangements made by Seaboard. They were not sold by Seaboard, as the Tax Court's opinion implies.

The Tax Court then went on to say that Seaboard was required to deposit certain Canadian dollars in escrow as security, as well as the 100,000 shares of Seaboard stock. This is directly contrary to the evidence in the following respects:

(1) It is not correct that the \$2,200,000.00 (Canadian) were deposited *in escrow*. Said money, which was, by the agreement, required to be deposited as cash collateral to secure performance of the contract, was required to be, and was in fact, deposited *with Industrial*, not in escrow [R. 29; 37]. The evidence to this effect is set forth in the letter which was sent to Seaboard by the Canadian Bank of Commerce wherein the Bank acknowledged receipt *from Industrial* of a receipt for \$2,200,000.00 (Canadian) [R. 37].

(2) It is not correct that the 100,000 shares of Seaboard stock were deposited in escrow as security for performance of the agreement of March 27, 1946. The reason for the deposit in escrow was to restrict Industrial's power of free disposition of the shares. If Industrial had had unrestricted possession of the shares, it could have, whether rightly or wrongly, attempted to market the shares in the United States, that being the only feasible or available market for the shares. Such marketing, however, would probably have been in violation of the Securities Act of 1933 in the absence of prior registration with the Securities and Exchange Commission. Hence the escrow requirement, which was merely a limitation upon the right of marketing. It could not have been a provision to secure Industrial, because the shares were issued to and owned by Industrial. It would have been meaningless for Industrial to deposit its own property as security for the performance by another person of the latter's obligation.

What the record shows is that Seaboard entered into a speculative agreement for the purchase of 50,000 shares of Campbell. To acquire ownership of the shares Seaboard agreed to issue, and did issue, to Industrial 100,000 shares of Seaboard stock. The transaction at this stage constituted an exchange of Seaboard stock for Campbell stock. Had this been an ordinary exchange, it would have ended there. However, Industrial extracted a guaranty from Seaboard that the 100,000 shares of stock were or would be equal in value to \$2,214,969.94 (Canadian). This guaranty was expressed in terms of an undertaking by Seaboard to arrange for the sale by Industrial of the 100,000 shares, with the further provision that if the sale did not produce the agreed figure, Seaboard would make

up the difference, either by the issuance of additional shares of Seaboard stock to Industrial or by the payment of cash.

The speculative feature of the contract lay in the expectations and hopes of Seaboard's management that the news of the acquisition by Seaboard of Campbell would stimulate activity in the over-the-counter market for Seaboard stock, thereby increasing its market value and the amount which would be realized by Industrial upon the marketing of its 100,000 shares of Seaboard stock. Reduced to simple terms, Seaboard attempted, in March, 1946, when its stock had a fair market value of \$12.50 per share, to acquire all of the outstanding stock of Campbell in exchange for 100,000 shares of Seaboard on the speculation that the fair market value of the Seaboard stock would increase sufficiently so that the entire cash amount which Industrial desired to obtain could be realized by Industrial from the sale of the Seaboard shares. Seaboard was not purchasing the Campbell stock for cash. Its desires and objectives were different from those of Industrial. Industrial wanted to receive a guaranteed cash amount which Seaboard was in no position to pay and did not want to pay. To reconcile this conflict, the transaction was set up on the basis of an exchange of Seaboard stock for Campbell stock, with Seaboard guaranteeing Industrial against loss on the transaction. Such an agreement is far different from an agreement to purchase for cash.

Had Seaboard been able to arrange a sale of Industrial's 100,000 shares of Seaboard stock at or around \$22.00 per share (which would have been possible in June or July, 1946 but for the intervention of delaying circumstances), Industrial would have realized the entire amount

which it sought, and Seaboard would have had no obligation to pay cash or to issue any additional shares of its stock. Had that occurred, Seaboard's cost of the Campbell stock would have been the fair market value on March 27, 1946 of the 100,000 shares of Seaboard's stock which were issued to Industrial on the exchange. 3 Mertens, *Law of Federal Income Taxation*, 374. That fair market value having been stipulated to be \$12.50 per share, Seaboard's cost would have been \$1,250,000.00, which was the approximate net book value of Campbell, and which was the amount that Seaboard proposed to pay for Campbell.

Had Industrial's 100,000 shares of Seaboard stock been marketed in June or July at \$22.00 per share, the Commissioner of Internal Revenue would be the first to object if Seaboard thereafter claimed a basis for the Campbell stock of \$2,200,000.00.

As it worked out, the sale of the 100,000 shares netted Industrial only \$1,440,000.00. This money belonged to Industrial, even though it was held in the United States by investment bankers. Under the contract Seaboard was required, under its guaranty, to make good to the extent of approximately \$763,000.00. Seaboard either had to issue additional shares of its common stock to Industrial or to pay that amount in cash.

It is at this point that the transaction in foreign exchange which resulted in a gain in Canada occurred. As the record shows, Seaboard had, in March, 1946, purchased \$2,200,000.00 (Canadian) and had deposited it with Industrial, as collateral. Because of the favorable exchange rate at that time, it had cost Seaboard only \$2,000,000.00 (United States) to acquire the Canadian dollars. But in November, 1946, when it came time for the

accounts of Seaboard and Industrial to be settled, the Canadian dollar was at parity with the United States dollar. At this point Seaboard authorized Industrial to apply some \$763,000.00 of the Canadian funds above referred to in satisfaction of Seaboard's guaranty. In addition, Seaboard and Industrial by mutual agreement effected an exchange of the remaining Canadian dollars back into United States dollars by the letter agreement of November 30, 1946 [R. 40-41].

The record is void of any evidence which would support the Tax Court's finding that the deposit with Industrial of the cash collateral was the payment for the Campbell stock, or not a separate transaction in foreign exchange. On the contrary, the evidence clearly shows that Seaboard could not pay cash, did not intend to pay cash, and never did pay cash except to cover its guaranty.

It was the uncontradicted testimony of W. A. Thompson that:

(1) It was necessary for Seaboard to move promptly in order to obtain the Campbell stock [R. 57].

(2) Seaboard made the offer of an exchange of its stock for Campbell's stock in lieu of a cash offer because Seaboard did not have funds available with which to make a cash purchase and thereafter to finance the Campbell operations; and because the Seaboard management foresaw the possibility of an appreciation in the market value of the Seaboard stock [R. 54].

(3) If the Seaboard stock issued to Industrial could be marketed on behalf of Industrial at a later date at a higher figure than that at which it was currently selling, Seaboard would be acquiring Campbell for substantially less cost [R. 54].

(4) The marketing of the Seaboard stock for the benefit of Industrial was delayed because of difficulties in completing an audit of Campbell Finance Corporation [R. 55-56].

(5) The cash collateral of \$2,200,000.00 (Canadian) was deposited with Industrial in order to guarantee the faithful performance by Seaboard of the agreement [R. 57].

(6) Seaboard was not interested in paying Industrial's asking price [R. 54].

The fundamental error of the Tax Court was in disregarding not only the form but the true substance of the transaction, and in finding, contrary to all of the evidence, and contrary to the true substance of the transaction, that in effect Seaboard caused to be sold to the public, for Seaboard's own benefit, 100,000 shares of stock in order to raise the funds necessary to finance the purchase of the Campbell stock.

B. Seaboard Could Not Determine the Cost of the Campbell Stock in March, 1946.

The Tax Court's erroneous analysis of the transaction led to its other fundamentally erroneous finding: that Seaboard's cost of the Campbell stock was determinable on March 27, 1946. It is then stated by the Tax Court that any gain which Seaboard may have experienced on the conversion of Canadian dollars was offset by a corresponding loss sustained between the purchase price of the Campbell stock converted into dollars at the date of purchase and the amount of United States dollars required to purchase the same number of Canadian dollars when payment was subsequently made. The Tax Court's position may be stated in the following way:

(1) Seaboard agreed to pay \$2,214,969.94 (Canadian) for the Campbell stock. At the rate of exchange in effect on March 27, 1946 that obligation, in terms of United States dollars, amounted to slightly in excess of \$2,000,000.00 (United States).

(2) The claimed gain on the exchange of Canadian currency was \$189,000.00, resulting from the increase in value of Canadian dollars between March and November, 1946.

(3) When the \$2,200,000.00 (Canadian) were applied in December, 1946 in discharge of Seaboard's obligation, they were worth in terms of United States dollars \$189,000 more than they were worth in March, 1946. Consequently Seaboard realized a loss on conversion exactly equal to the claimed gain.

The defect in this reasoning is that its major premise is unsound and is not supported by the facts. There was no fixed purchase price in terms of United States dollars on March 27, 1946, unless that purchase price is taken to be the then fair market value of the 100,000 shares of Seaboard stock.

Seaboard argued below that it could not determine its cost until events subsequent to March 27, 1946 had occurred. The Tax Court dismissed this argument by a mere assumption [R. 47-48]. The Tax Court said: "We assume that under the principles stated petitioner could and should have determined its cost as of March 27, by the mere process of computing from the fixed amount of \$2,214,969.94 Canadian at the then rate of exchange its cost in American dollars. In the end result and regardless of what occurred on the marketing of the stock, those Canadian dollars were required to be paid."

Said statement demonstrates the second fundamental fallacy in the Tax Court's approach to this case. To be sure, had Seaboard agreed to pay cash for the Campbell stock, under applicable principles of law Seaboard's cost could have been determined on the date that the contract was signed. But the error of such an analysis has already been described. What Industrial may have sought to achieve from this transaction is not controlling in determining the legal consequences of what Seaboard did. Seaboard issued 100,000 shares of its stock in exchange for 50,000 shares of Campbell stock. The March 27, 1946 agreement expressly so stated and provided. Seaboard at the same time guaranteed to Industrial that its shares would be worth approximately \$22.00 per share; and if they were not, that Industrial would be entitled to receive either additional shares to make up the difference or a cash payment.

All that Seaboard had paid or agreed to pay on March 27, 1946 was 100,000 shares of its common stock, which shares were in fact immediately issued to Industrial. Had it been possible for Industrial to market those shares within two to three months following the date of their issuance, Seaboard would have had no cash payment to make to Industrial, and it would have been entitled to receive back from Industrial the \$2,200,000.00 (Canadian) which had been deposited as cash collateral. Had those events occurred as Seaboard had hoped they would occur, it would seem very clear that the only cost that Seaboard could claim for the Campbell stock was the fair market value of the 100,000 shares of Seaboard stock which were issued in exchange therefor. Thus, Seaboard would have had a basis for the Campbell stock of \$1,250,000.00. Moreover, quite clearly, the conversion of the

cash collateral deposit back into United States dollars and the return thereof to Seaboard would have constituted a completed transaction in foreign exchange upon which gain or loss should be recognized.

It is fallacious to say, as the Tax Court did, that because events did not occur as Seaboard had hoped the transaction became something else. The happenstance of a decline in the market for Seaboard stock commencing in mid-July, 1946 does not alter the transaction which was entered into in March. It required Seaboard to do certain things which it had hoped it would not have to do; but it did not retroactively change an uncertain purchase price into a certain one.

The Tax Court erroneously believed that the cost to Seaboard of the Campbell stock had to be determined as of March 27, 1946. It may be assumed that ordinarily when one person purchases something from another person, the price will be fixed as of the date the transaction is made. Under such circumstances the doctrine of the *Bernuth-Lembcke Co., Inc.*, and *Joyce-Koebel Co.* cases, *supra*, would be applicable. But that doctrine does not have to be applicable in all cases, and we submit that it is not applicable here. The Tax Court said:

“If the cases in question are applicable petitioner could have computed its cost. And they therefore cannot be held inapplicable on the ground that petitioner could not compute its cost.” [R. 48.]

But this statement of the Court is based upon the *assumption* that Seaboard could and should have determined its cost as of March 27. If, for the reasons herein stated, Seaboard could not determine its cost as of March 27, then the cases referred to, in so far as they relate to the

determination of purchase price, are inapplicable to the present state of facts. They are distinguishable because the facts are different. We submit that the Tax Court's assumption, and the findings based upon such assumption, were clearly erroneous.

By virtue of the fluctuation in the rate of exchange, Seaboard realized a gain of \$189,000.00 from the purchase and subsequent use of Canadian currency. That gain must be recognized and accounted for as a Canadian gain unless the Tax Court correctly found that there was no such transaction. We submit that there is no evidence whatever to support the Tax Court's finding that the Canadian dollars which were deposited with Industrial were payment, at the date of deposit, for the Campbell stock, and that there was, therefore, no separate transaction in Canadian exchange. We further submit that the Tax Court erred in its assumption that Seaboard could determine its cost on March 27, 1946.

IV.

Conclusion.

The Tax Court concluded its opinion with the observation that Seaboard was in fact no better off or worse off by reason of its transactions in Canadian currency. This is manifestly an erroneous observation. In terms of United States dollars the Canadian currency which Seaboard purchased in March, 1946 was more valuable, by \$189,000.00 in December, 1946. Seaboard realized the benefit of this fluctuation. Judge Opper, the Tax Court judge who decided this case below, has recognized that:

“There seems * * * no reason to disturb the well established principle of such cases as *Bernuth-*

Lembcke, 1 BTA 1051, nor indeed to suggest without qualification in the words of *B. F. Goodrich, supra* [1 T.C. 1098] that 'mere borrowing and returning of property does not result in taxable gain.' * * * In both such situations a collateral transaction in foreign exchange may be involved. * * * The full scope of a taxpayer's gain or loss will not be given effect in his tax liability unless the foreign exchange transaction is also dealt with." *Willard Hilburn, Inc.*, 20 T. C., No. 106 (June 30, 1953).

Unless the purchase and disposition of Canadian currency here in question was nothing more than a cash payment for the Campbell stock, Judge Opper's language quoted above would appear to require that the exchange gain be recognized. We submit that in terms of United States dollars Seaboard profited to the extent of \$189,000.00. The computation of its Canadian income tax credit should give full recognition to that gain.

Respectfully submitted,

DANA LATHAM,
AUSTIN H. PECK, JR.,
HENRY C. DIEHL,

Attorneys for Petitioner.

Dated: January 22, 1953.